

***Remarks of John M. Reich, Director
Office of Thrift Supervision
to the American Bankers Association Summer Meeting
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Good morning. I appreciate the opportunity to be here this morning. It's always great to be back in my adopted home state of Florida where I was in the banking business for over 20 years.

I don't need to tell this group how serious the challenges to our industry are today. The media coverage of our recent closure of IndyMac Bank, the constant speculation in the news about the future of Fannie Mae and Freddie Mac, as well as the speculation about the bank and thrift industries overall have shaken the confidence of consumers and investors alike. They no longer have confidence in the financial health, transparency and integrity of our industry. Without confidence, there can be no recovery.

This morning I'm going to talk about 3 keys to restoring confidence in the Industry:

1. Attention to risk management;
2. Leveling the playing field; and
3. Avoiding interference

So, let me elaborate on the first – attention to risk management.

Our industry and the economy overall have been hit hard by a continuing housing downturn. The economy remains in a slump. GDP growth, though still positive, is down. Existing home sales have fallen and the number of homes available for sale has risen to the highest level since 1985. Homes lingering on the market have caused a considerable pullback in new home construction. Delinquencies and foreclosure continue to rise and borrowers with option ARMs face headwinds from loan recasts due to negative amortization triggers.

To date, the hardest hit financial institutions have been those with an “originate-to-sell” business strategy, particularly in California, Florida, Nevada and Arizona. However, in this environment, even community-based banks and thrifts with an “originate to hold” business model could be affected because they generally have a higher-than-average percentage of assets in construction loans, nonresidential loans and consumer loans.

It is clear now that bank risk management practices were not sufficiently robust to forestall the current crisis and accurately assess the scope of its impact. The current

economic environment presents significant challenges, particularly in the areas of credit quality and asset management. It is crucial that we take a step back and examine the processes and systems in place to identify and manage any current or potential increase in the level of problem assets. All institutions must be proactive in provisioning for loan losses and building sufficient loan loss reserves.

I believe we will turn this around and restore that essential level of confidence in our industry, but it will not happen without concerted effort on your part and on the part of the financial services regulators, including OTS, to pay even greater attention to risk management.

Recently, I have traveled the country reiterating this message and stressing specific areas where managers should be assessing the risks that your institutions face in the current economic climate. OTS has written to thrift CEOs nationwide outlining supervisory expectations, and have emphasized these subjects during town hall meetings and several Credit Forums focused on business planning, risk analysis and monitoring, account servicing and problem asset management.

First and foremost, sound underwriting that involves consideration of the 5 C's of credit administration is the most basic principle of lending. In light of the housing and economic environment, institutions should also ensure the proper level of attention to business planning, risk analysis and monitoring, account management and problem asset management. As home values continue to drop and ARMs (particularly Option ARMs) continue to adjust upward, management should establish loss mitigation strategies, which might include increasing servicing staff levels; designating loan modification and short sale criteria; and appropriate on-going accounting for troubled debt restructurings and REO.

But what about the mortgage originators that are not depository institutions and are not subject to the same level of regulatory scrutiny? All the emphasis on risk management in the world cannot correct industry problems if a significant number of those who originate mortgages—mortgage brokers and mortgage companies—are not subject to bank-like regulations and supervision.

This brings me to the second key: leveling the playing field.

I believe Congress should help create a level, scrupulous and well-regulated playing field so consumers and investors have confidence in the transparency, fairness and integrity of all mortgage originations. The standards of the under-regulated segments of the market must be raised to the level followed by the federally regulated segments. All entities that

originate home loans should be required to comply with basic credit principles, such as conducting a reasonable assessment of each borrower's ability to repay.

A "level playing field" did not exist when the mortgage crisis began a few years ago and in that environment, even well-regulated banks and thrifts felt pressure to compete with the products offered by their less regulated mortgage competitors. A level playing field still does not exist today.

At the OTS, we are crafting and will soon be ready to discuss details of our "Financial Institution Reform Initiative," which will propose the best ways to implement a new regulatory system. As part of this initiative, we will propose that the OTS be given additional authority to supervise mortgage brokers and mortgage companies currently subject to a less stringent regulatory and supervisory framework than the one applying to insured depository institutions. The OTS proposal will draw on the expertise developed by our agency over the years in regulating and supervising entities that are primarily mortgage lenders.

Several essential elements of the proposal are already clear:

- We would require nationwide registration and licensing for all mortgage originators, because accountability is vital to avoid predatory and irresponsible lending.
- We would require all originators to have underwriting and origination expertise and utilize strict underwriting standards. Not just anyone should be allowed to deal with homebuyers and originate mortgages.
- We would require annual continuing education and biannual mandatory training.
- We would require mortgage brokers and companies to possess adequate financial resources to ensure a level of stability and commitment. Such a requirement could include a minimum net worth or the ability to obtain a bond.
- Finally, we would tie compensation for loan officers to responsible underwriting practices to assure that they offer loans only to borrowers who have a reasonable prospect of repaying the loan. Mortgage brokers could receive their commission over a three-year period based on the continued performance of the mortgage.

I believe these elements of the forthcoming OTS proposal would serve borrowers' interests, as well as those of lenders and investors.

Selecting a strong regulator to monitor this new level playing field is critical for protecting consumers and restoring market confidence. I won't pretend to be a disinterested party, but I know that the OTS has the most extensive expertise of any regulatory agency in the oversight and supervision of mortgage banking operations and I believe the OTS is in the best position to assume federal authority to regulate the currently unregulated players in mortgage banking.

OTS has a solid budget, healthy reserves and a growing workforce to take on this challenge. We employ more than 1,000 people, having increased our staff by about 15 percent since I took office in August 2005. Our staff has vast experience relevant to the home mortgage business. Our regulatory approach focuses on maintaining a safe, sound and thriving mortgage lending industry and protecting consumers who rely on our institutions to fill their financial services needs. We strive to achieve those goals without unnecessary burden on the industry. We believe that the private sector must be allowed to innovate, compete and prosper—but not at the cost of consumers.

The third key to restoring confidence - avoiding interference - is important because, even if our industry sticks to stringent risk management principles, and all mortgage originators are made to abide by the same rules, confidence in the industry can still be derailed by interference. When I say interference, I mean interference with the regulatory process by reporting and disseminating speculation about the condition of financial institutions, thereby undermining public confidence in those institutions and causing serious harm.

I can give you a number of recent egregious examples, including the recent failure of IndyMac about which you have already heard plenty. IndyMac had been in a troubled financial situation that was caused, in part, by unprecedented stress in the residential real estate market, combined with the evaporation of the non-agency secondary mortgage market in August of 2007. The OTS had significant concerns with the bank's funding strategy, had directed appropriate changes and was finalizing a new set of enforcement actions to address its numerous problems. IndyMac was actively seeking to arrange a significant capital infusion or find a buyer. All prospects of rescuing IndyMac disappeared after a June 26 letter to the OTS and the FDIC from Senator Charles Schumer that publicly expressed concerns about IndyMac's viability and caused depositors to withdraw approximately \$1.3 billion from their accounts.

The IndyMac closing led to further speculation about other banks and thrifts that might be in trouble, fueled by widespread media coverage—especially among television stations—about lists of problem banks developed by research firms and analysts. Seemingly oblivious to the fact that they could drive otherwise healthy banks to fail and

push troubled institutions away from potential solutions toward ruin, TV reporters staked out banks on these rogue lists, interviewed customers and stoked public fears.

In a time when consumer confidence is already flagging and the general public is skittish and understandably concerned about what their financial futures will hold, this behavior goes beyond irresponsible. It's reprehensible.

I am an ardent believer in free speech and the First Amendment, but I also know our Supreme Court has ruled that free speech has its limits. You cannot scream "fire!" in a crowded theater. Nor, in my view, should anyone feel free to scream "failure!" in a bank lobby. This, in effect, is what happened across America just last week and it was shameful.

There are other recent examples of irresponsible statements leading to unwarranted harm. Two week ago Lehman Brothers analysts said an accounting change might force Fannie Mae to add \$46 billion in capital and Freddie Mac to add \$29 billion. Before this statement could be refuted, stock shares plunged as much as 26 percent for Fannie and 29 percent for Freddie, both reaching their lowest prices in 13 years. Richard Syron hit the nail on the head when he said, "Markets are moved by information, but in periods like this, they are also moved by fear."

There is irony in Lehman's accusations about the GSEs. Back in April, Richard Fuld, CEO of Lehman Brothers, blamed short sellers for a drop in Lehman's stock price claiming they spread rumors about Lehman Brothers and whispered that Lehman looked like the next Bear Stearns. Again in early July, Lehman's stock price plunged 11 percent in the space of three hours based on unfounded chatter that Lehman was about to be sold to Barclays.

In this age of instant telecommunications when information moves at the speed of light, rumors are particularly potent. They can move markets and destroy institutions. Particularly in a bear market, this is true. SEC Chairman Chris Cox seemed to recognize the problem in a letter to the Basel Committee. After Bear Stearns was sold to JPMorgan, he talked about rumors that had been spread about liquidity problems and said that Bear's undoing "was the result of a lack of confidence, not a lack of capital." Personally, I believe that the SEC should aggressively pursue rumors that fraudulently manipulate markets.

It is my hope that perpetrators of damaging misinformation will consider the consequences of their actions before the damage is done and that, when their actions are illegal, they should face the consequences. I would also hope that further public discussions or media stories regarding insured depository institutions would include a

reminder to the public that the deposit insurance system is safe and that no depositor has ever lost a penny of insured deposits in an FDIC insured bank or thrift.

In conclusion, I believe it's important that the industry and the regulators address the weaknesses which have existed in risk management, and I believe it's equally important for Congress to address the issues of leveling the playing field, and avoiding interference.

Finally, I'd like to take this opportunity to invite each of you to attend our third annual National Housing Forum on December 8 at the National Press Club in Washington. It has been a great event in the past and I expect it will be a big success again this year. I hope to see you there.

Thank you.